A Look at Insurance Options

Excess Versus Umbrella Insurance

By Gail S. Kelley, P.E.

Although the terms "excess insurance" and "umbrella insurance" are often used interchangeably, an excess insurance policy is not the same as an umbrella insurance policy. Both policies provide liability coverage, i.e. coverage that protects against claims of damage or injury to others or their property. Both increase the policyholder's liability limits above those of specifically listed underlying policies and both protect against catastrophic risks, with coverage typically only provided in multiples of $1,000,000. However, excess liability policies only provide coverage above the limits of the underlying primary insurance; true umbrella insurance will provide coverage for additional risks.

Excess Insurance Coverage

Excess insurance policies can be either self-contained (stand alone) or "follow form". A self-contained policy has its own insuring agreement, conditions, definitions and exclusions; coverage applies to the extent described in the policy. In contrast, a follow form policy will simply state that it only applies if the loss is coverd by the underlying insurance. Coverage is subject to the same basic terms and conditions as the primary insurance. Neither self-contained nor follow form excess liability policies offer broader protection than what is provided by the underlying policies. In fact, excess liability policies, even those written as follow form, often have exclusions that make them more restrictive than the underlying coverage.

Excess Insurance Limits

Most excess insurance policies will increase both the each-occurrence limit and the aggregate (total) limit of the underlying policy. For example, if the underlying policy is a Commercial General Liability (CGL) policy with an each-occurrence limit of $1,000,000 and an aggregate limit of $2,000,000, an excess insurance policy for $1,000,000 would increase the each-occurrence limit to $2,000,000 and the aggregate limit to $3,000,000.

Umbrella Liability Coverage

While excess insurance policies typically provide coverage for one underlying policy, umbrella policies typically provide coverage for several underlying policies. In addition, umbrella policies typically provide coverage not available in the underlying policies; such policies are often written in an "A/B format." Coverage A represents excess coverage and is written to "follow form" the underlying policies. The policy increases the each-occurrence limits of the underlying policies and drops down when an underlying policy's aggregate limit is exhausted or reduced by payment.

Coverage B is the umbrella coverage; it applies when there is no coverage under an underlying policy. However, Coverage B will not apply to any claim for which applicable insurance is listed in the schedule of primary policies, even if the underlying insurance is uncollectible. In addition, Coverage B will specifically exclude coverage for various risks. Common exclusions are liability for asbestos, expected or intended injury or damage, workers compensation, aircraft, watercraft, unemployment compensation, pollution, liquor liability, contractual liability, damage to the insured's product; and damage to property in the insured's care, custody or control. Some umbrella policies also exclude coverage for professional liability.

Coverage B is typically subject to the insured's assumption of a self-insured retention (SIR). An SIR is similar to a deductible, in that it is the amount the insured is obligated to pay. However, when a liability policy has a deductible, the insurance company pays the entire amount and then bills the insured for the deductible. When the policy has an SIR, coverage does not begin until the insured has paid the SIR. In addition, deductibles usually only apply to judgements and settlements; an SIR usually applies to defense costs as well as judgements and settlements.

Umbrella Versus Excess Policies

Excess policies are sometimes designed to cover a risk that cannot be covered under an umbrella policy, such as liability arising out of the operation of a plane or high performance speed boat. Such policies are generally much more expensive than umbrella coverage in terms of premium costs versus amount of coverage. Excess insurance can also be used to bring coverage up to the limits required for an umbrella policy, or can be designed to "sit on top of" an umbrella policy to provide additional coverage for certain risks.

Duty to Defend

Excess policies are typically written such that the insurer has the right to defend against a claim, but is not required to do so. This is referred to as claim participation; a typical claim participation clause will state: "The Insurer may, at its sole discretion, elect to participate in the investigation, settlement or defense of any claim covered by this Policy even if the Underlying Insurance has not been exhausted." If the excess insurer elects not to participate, the primary insurer must pay for the attorney fees and other legal costs to defend against a claim, even if the amount of the claim is such that the excess policy would be reached.

Umbrella policies usually do include the duty to defend. Although defense coverage may be limited to occurrences not covered by underlying insurance, some umbrella insurance policies provide defense coverage once the limits of the underlying insurance have been exhausted. An example of when this might apply is when there are several claims resulting from the same occurrence. If the first claim is settled for the each-occurrence limit of the underlying insurance, the umbrella insurer would have the duty to defend against the additional claims.

Sub-limits

Liability insurance will often have specific sub-limits, such that coverage for certain risks is much lower than the policy limits. As an example, under a standard CGL policy, the coverage limit for fire damage to property leased by the insured is $50,000, regardless of the CGL each-occurrence coverage. Most umbrella or excess insurance policies do not drop down to provide coverage in excess of any sub-limits; specialty insurance is needed to provide such coverage.

Loss of Underlying Coverage

Neither excess nor umbrella policies will drop down to provide coverage when the underlying insurer denies coverage because the insured did not comply with provisions of the underlying policy. Likewise, they will not drop down when underlying coverage is uncollectible due to insolvency of the insurer. The insured becomes liable for costs up to the limits of the underlying policy.

In some cases, the underlying insurer may state that a claim does not fall within its policy and thus denies coverage. Rather than suing for coverage, the insured may prefer to settle with the insurer for some amount less than its policy limits. If the claim is such that an excess or umbrella policy would be reached, the law in most states holds that the insured is entitled to coverage under that policy once it has paid the limits of the underlying policy.

Claims Against an Umbrella Policy

Umbrella insurance with a policy limit of $1,000,000 will increase the limits of each of the underlying policies by $1,000,000. However, the umbrella coverage available for all of the underlying policies is reduced by the amount of any payment from the umbrella policy. A catastrophic claim on one underlying policy could completely exhaust the umbrella coverage for all of the policies.

Nevertheless, the premium for an umbrella policy will be considerably less than the cost to increase the limits of each of the underlying policies by the amount of the umbrella policy. Umbrella policies are thus an attractive way to increase coverage, provided the risk of catastrophic claims is low.

Conclusion

There are no standardized forms for umbrella and excess insurance policies, and coverage definitions are developed by the individual insurance companies. As a result, excess insurance policies from different insurers can vary greatly in what they cover. For example, an excess policy might increase the limits of the each-occurrence coverage, but not the aggregate coverage.

Likewise, when considering an umbrella policy, it is worth comparing several policies to see what additional coverage is provided and what defense costs are covered. Although insurers typically state that umbrella insurance will help close or eliminate "gaps" in the underlying insurance, policies tend to have a long list of exclusions. Some of the exclusions are reasonable because coverage is available under other policies, such as workers compensation and pollution liability policies. Other exclusions, such as damage to the named insured's product or work, are viewed as a business risk that the insured should be responsible for. However, when all of the exclusions are considered, it may not be clear what additional risks are covered.▪

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